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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 39

LOUIS LOBER, CHARLES LOBER AND ALMA T. LOBER, AS EXECUTORS OF THE LAST WILL AND TESTAMENT OF MORRIS LOBER, DECEASED, PETITIONERS

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The majority and dissenting opinions of the Court of Claims (R. 29-33) are reported in 108 F. Supp. 731.

JURISDICTION

The judgment of the Court of Claims was entered on December 2, 1952 (R. 36). On December 31, 1952, the petitioners filed a motion for rehearing which was overruled on February 3, 1953 (R. 36). The petition for a writ of certiorari was filed on April 1, 1953, and was granted

on June 1, 1953 (R. 37). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1255 (1).

QUESTION PRESENTED

Decedent created three trusts, one for each of his minor children, each trust instrument providing that the decedent, as trustee, should collect the income and in his discretion accumulate it in whole or in part, such accumulations to be paid over to the beneficiary when he reached his majority, the principal to be paid to such beneficiary when he reached the age of 25 years. The decedent reserved the power in his discretion to make payments to the beneficiary from the principal of the trust estate at any time. The question presented is whether the value of the assets of these three trusts is includible in decedent's gross estate under the provisions of Section 811 (d) (2) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The pertinent portions of the statute and regulations are set forth in the Appendix, *infra*, pp. 47–50.

STATEMENT

The petitioners are executors of the last will and testament of Morris Lober, who died a resident of the State of New York on December 13, 1932 (R. 33).

The decedent, on October 31, 1924, created a trust for the benefit of his son, Robert T. Lober

(R. 33). The trust instrument provided for the transfer by the donor to himself, as trustee, of certain property in trust to hold, invest and reinvest the same and to collect and receive the income thereof during the life of Robert T. Lober, or until he should reach the age of 25 years, the net income so collected to be never at any time either in whole or in part expended for the maintenance, education and support of Robert T. Lober during his minority, but to be accumulated for his benefit in whole or in part, as the trustee might deem proper, such accumulations of income, if any, to be paid over to Robert T. Lober upon his reaching his majority. The principal of the trust estate or the remaining portion thereof was to be paid over to Robert T. Lober when he reached the age of 25 years (R. 5-6).

The trustee in his discretion could make payments to Robert T. Lober from the principal of the trust estate, the amount and time of such payments to rest in the discretion of the trustee, and any and all of the sums so paid were to be entirely freed from the trust and to be the absolute property of the payee (R. 6).

The instrument further provided, after giving the trustee general control over investments, that in case of the donor's death before the son reached the age of 25 years, the wife of the donor should be appointed trustee with the same powers and rights as conferred upon the donor as trustee (R. 7).

On March 15, 1929, decedent created a separate trust for the benefit of his son, James Morris Lober, and on March 18, 1929, another trust for the benefit of his daughter, Maxine Lober. The provisions of these two trust instruments were substantially identical with those of the trust for the benefit of Robert T. Lober (R. 33–34).

In the estate tax return of the decedent, the value of these three trusts was not included as part of decedent's gross estate. The Commissioner of Internal Revenue determined a deficiency in estate tax, resulting in part from the inclusion in the estate of decedent of all the assets of the three trusts above mentioned. The deficiency, together with interest, was duly paid, a timely claim for refund was filed, and this suit was brought in the Court of Claims within two years from the rejection of the claim (R. 34–35).

The Court of Claims, upon the foregoing findings of fact, held that the petitioners were not entitled to recover, and dismissed the petition (R. 35).

SUMMARY OF ARGUMENT

As the court below held, this case is controlled by *Commissioner* v. *Estate of Holmes*, 326 U. S. 480. Here, as in *Holmes*, the decedent's power to confer upon the beneficiaries, by terminating the trust, present enjoyment of assets they might otherwise never enjoy was clearly within the provision of Section 811 (d) (2) which taxes all

transferred assets in the "enjoyment" of which the decedent had power to effect "any change".

I

1. Even on petitioners' assumption, in our view erroneous, that the interests of the beneficiaries were indefeasibly vested, the rule in *Holmes* applies. As this Court there affirmed, the words "'enjoyment' and 'enjoy,' as used in these and similar statutes, are not terms of art, but connote substantial present economic benefit rather than technical vesting of title or estates." 326 U. S. at 486. The critical fact, then, is that the decedent retained the power to confer upon the beneficiaries either "substantial present economic benefit" or no present benefit at all.

The assumption that the beneficiaries' interests were "indefeasibly vested" means merely that, had they died during the term of the trust, the property would have passed through their estates. But, as shown by the decision in *Mellon v. Driscoll*, 117 F. 2d 477 (C. A. 3), certiorari denied, 313 U. S. 579 (which, conflicting with the Fifth Circuit's decision in *Holmes*, was a basis for certiorari, and was cited by this Court with approval, in that case), the power to pass property at death differs sharply from the power to use, expend, or otherwise enjoy the property during life.

2. There is no basis for escaping the tax in petitioners' argument that the decedent had power to effect a "mere acceleration of the time of enjoyment * * *." In this case, as in most imaginable cases, the power "merely" to accelerate was unmistakably sufficient to make the difference between enjoyment and the distinct possibility of no enjoyment. And so the sweeping language of Congress, covering powers to make "any change" in enjoyment, plainly includes the power retained by the decedent.

3. Equally unavailing to petitioners is the contention that the transfers in this case were "complete" when made. For it is clear that Section 811 (d), like subsections (c) and (e), reaches completed transfers. Thus, although transfers subject to a power of revocation exercisable jointly by the settlor and a person having an adverse interest are completed gifts (*Reinecke* v. *Northern Trust Co.*, 278 U. S. 339), they are nevertheless taxable under Section 811 (d). *Helvering* v. *City Bank Co.*, 296 U. S. 85. For when Congress used powers of revocation exercisable in conjunction with "any person" it meant nothing less. Similarly, the statutory reference to "any change" in "enjoyment" plainly includes the substantial changes the decedent in this case retained power to effect.

It is, then, no bar to the estate tax that transfers of the type involved here might be subject to the gift tax when made. Recognizing that the

two taxes are not mutually exclusive, Congress provided specifically in Section 813 of the Code for the crediting of gift tax payments against the estate tax. Far from precluding the estate tax, the gift tax simply "amounts in some instances to a security, a form of down-payment on the estate tax which secures the eventual payment of the latter." * * *" *Smith v. Shaughnessy*, 318 U. S. 176, 179.

4. There is no substance in the argument (Pet. Br. 8, 20) that the decision below would require taxation in a decedent's estate of a gift he had made to his minor child with himself as guardian. It may be noted that the argument assumes the decedent to have done a meaningless thing when he created his trusts and reserved the power to change them to the arrangement petitioners contend is no different. But the decedent's plan made sense; guardianship would have been a much different, far more limited role than that he retained. As guardian, he would have been sharply restricted in the investments he could make, not completely unfettered as he was under the trusts. As guardian, subject to close and continuing judicial supervision, he would have had far less power than he reserved as trustee to turn the assets over to the children for investment or consumption. And as guardian, he would have lost control over the property when the children reached majority, whereas he retained such control under the trusts until the children reached 25.

significant that the trusts here were older when they were created shortly after the beneficiaries were born, that they postponed to the future settlement of the beneficiaries to the payments of either principal or interest, that neither retained, as trustee, practically unlimited power to control and invest the property, and to determine in his discretion when or if the children were ready. (Unless the trust terminated) to control the property themselves. In these circumstances, it makes no sense to say that the settlor would have wished the property to pass to the intestate distributees of a deceased child or by the will of a child to the end that the settlor endure enough to have control of the property. It is far more reasonable to assume that the settlor would have wished the property to return to him if a child died before receiving it.

This conclusion, applied to the particular terms of the trusts involved here, is supported by the very fact that some publishers cite *Second Church Trust Co. v. Chase National Bank*, 121 Misc. 45, 201, affirmed without opinion, 209 App. Div. 799, affirmed without opinion, 239 N. Y. 526. It accords with the general view that it is always reasonable to assume trust property to be safer there than to have it go to the heirs of the beneficiary." Mr. Justice Reed, concurring in *Spiegel* v. *Commissioner*, 335 U. S. 701, and dissenting in *Commissioner* v. *Church*, 335 U. S.

[redacted]

The same reasoning requiring a contrary construction as to the trust principal applies to the accumulations.

3. It is clear, in any event, that petitioners have failed to demonstrate that New York law provides the ground they invoke for attacking the Commissioner's assessment. *Cf. Helvering v. Fitch*, 309 U. S. 149, 156. They are left with no basis for even the attempt to distinguish *Commissioner v. Estate of Holmes*.

Statutes

Section 811 (d) of the Internal Revenue Code (Appendix, *infra*, pp. 47–48) requires the inclusion in a decedent's gross estate of all property "[t]o the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend or revoke . . . ." In *Commissioner v. Estate of Holmes*, 326 U. S. 480, the decedent had created three irrevocable trusts for his three sons, giving each the beneficial interest in one-third of a common trust. The trusts were to continue for 10 years unless terminated earlier by the settlor, and each of the sons, if living, was to receive the corpus of his trust on termination. The shares of any deceased son were to be paid to his issue, and on failure of issue to the other two sons or their surviving issue. The income of each trust, subject to spendthrift provisions and discretionary power of accumulation, was to be dis-

tributed to the beneficiary if not accumulated. The settlor, who was named and acted as trustee until his death, reserved to himself during his lifetime the power to terminate the trusts and to distribute the principal with accumulated income to the beneficiaries then entitled to receive it. This Court held that the interests the decedent had transferred remained subject at his death to a change in enjoyment through exercise of his power to terminate and distribute the corpus to the beneficiaries, and that the trust assets were accordingly taxable as part of the decedent's estate.

That holding, we submit, applies squarely to the substantially similar facts presented here. Petitioners contend (Br. 7, 15) that under New York law the interests of the beneficiaries in this case were "unconditionally vested"—*i. e.*, that the interest of any beneficiary dying during the term of the trust would have passed to his estate—and that this factor requires a result different from *Helvering*, where the trusts provided for gifts over. The court below, assuming, without deciding, that the taxpayers were correct in their view of New York law (R. 31), held that the proposed distinction made no difference. It said (R. 32):

> * * * A father who has the power to decide that his son should have certain assets to use, enjoy, spend, waste or invest, or to decide that he shall not have them at all for any of these purposes, but that his

> creditors, his children, wife, or collateral relatives should have them, has a significant control over the assets. We think it is substantially the kind of control which the Supreme Court was dealing with in *Commissioner v. Holmes*.

We contend, as the first point of our argument, that the Court of Claims was right in this conclusion.

Secondly, however, we shall show that even if petitioners' attempted distinction of *Holmes* were significant, the attempt has failed. Petitioners implicitly recognize (Br. 11–13, 15, 19), as they must, that if the interests of the beneficiaries of the trusts were *not* "unconditionally vested"—if, that is, upon the death of any beneficiary his interest would have returned to the settlor—this case duplicates *Holmes* in every conceivably material detail. They assert with confident brevity (Br. 11) that "It is established beyond any doubt under New York law * * * that the beneficiaries had unconditionally vested interests in the principal * * * and in any income accumulated during minority * * *" (citations omitted). But we think the terms of the *inter vivos* trusts involved here would require a contrary conclusion under New York law. At the very least, petitioners have failed to sustain their burden of establishing the asserted rule of state law upon which they seek to upset the Commissioner's assessment.

I

THE DECEDENT'S RESERVED POWER TO ACCUMULATE INCOME AND TO TERMINATE THE TRUSTS BY DISTRIBUTING THE PRINCIPAL TO THE BENEFICIARIES AT ANY TIME WAS A POWER TO CHANGE THE ENJOYMENT OF THE INTERESTS HE HAD TRANSFERRED, REQUIRING INCLUSION OF THE TRUST ASSETS IN HIS GROSS ESTATE

Holding taxable in the estate of the settlor-trustee the trust assets involved in *Commissioner v. Estate of Holmes*, 326 U. S. 480, this Court said (326 U. S. at 487):

> It seems obvious that one who has the power to terminate contingencies upon which the right of enjoyment is staked, so as to make certain that a beneficiary will have it who may never come into it if the power is not exercised, has power which affects not only the time of enjoyment but also the person or persons who may enjoy the donation. More therefore is involved than mere acceleration of the time of enjoyment. The very right of enjoyment is affected, the difference dependent upon the grantor's power being between present substantial benefit and the mere prospect or possibility, even the probability, that one may have it at some uncertain future time or perhaps not at all. A donor who keeps so strong a hold over the actual and immediate enjoyment of what he puts beyond his own power to retake has not divested himself of that degree of control which

§ 811 (d) (2) requires in order to avoid the tax.

That conclusion fits this case.'

Here, as in *Holmes*, the three trusts reserved to the settlor the power to accumulate income—in this case, until the beneficiaries reached the age of 21, which none had at the time of the settlor's death. Here, similarly, reserving the power to make distributions of principal to the beneficiaries, the trustee could terminate the trusts at any time by such distributions. Here, in short, as in *Holmes*, because a beneficiary might die before the period of the trust had ended, the settlor's reserved power to terminate was a power "to make certain that a beneficiary [would] have [the right of enjoyment] who [might] never come into it if the power [was] not exercised * * *."

The single distinction upon which petitioners would base the different result for which they contend is that here the particular persons who

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[1] The rule of *Commissioner* v. *Estate of Holmes* has been applied to impose taxes on the estates of decedents who, in a variety of ways fundamentally similar to the devices involved here, have retained over properties transferred in trust a power to change the right of enjoyment created by the transfer. See, *e. g.*, *Hurd* v. *Commissioner*, 160 F. 2d 610 (C. A. 1); *Thorp's Estate* v. *Commissioner*, 164 F. 2d 966 (C. A. 3), certiorari denied, 333 U. S. 843; *Commissioner* v. *Newbold's Estate*, 158 F. 2d 694 (C. A. 2); *Loughridge's Estate* v. *Commissioner*, 183 F. 2d 294 (C. A. 10), certiorari denied, 340 U. S. 830; *Hauptfuhrer's Estate* v. *Commissioner*, 195 F. 2d 543 (C. A. 3), certiorari denied, 344 U. S. 825.

would take the property in the event of the death of the named beneficiary were not designated in the trust instrument, whereas the trusts in *Holmes* provided for gifts over to the surviving issue of a named beneficiary or to the other beneficiaries or their issue. Arguing that the beneficiaries in this case had inheritable estates under New York law and that each beneficiary's heirs are "carried within the beneficiary during his lifetime" (Pet. Br. 15), they claim that the power reserved by the settlor here cannot be viewed as a power to change enjoyment within the meaning of Section 811 (d) (2).* Assuming for the moment that petitioners correctly state the law of New York (but see pp. 32-45, *infra*), their conclusion is nevertheless erroneous.

1. It was settled in *Commissioner* v. *Estate of Holmes* that a power, like the one reserved by the

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*There are no express spendthrift provisions in the trusts involved here as there were in *Holmes*, but this fact is immaterial, and petitioners, while mentioning it (Br. 7), properly refrain from placing any special reliance on it. For under New York law, the trusts amounted to spendthrift trusts. Section 15 of New York's Personal Property Law (McKinney's Consol. Laws of N. Y., Bk. 40) provides:

> The right of the beneficiary to enforce the performance of a trust to receive the income of personal property, and to apply it to the use of any person, cannot be transferred by assignment or otherwise.

This provision "in effect make[s] every trust in New York a spendthrift trust so far as life interests are concerned, where the beneficiary has not created the trust for his own benefit." Griswold, *Spendthrift Trusts* (2d ed., 1947), p. 241. See, *e. g.*, *Matter of Ungrich*, 201 N. Y. 415.

If, as we argue below, the beneficiaries in this case had no inheritable estate, the *Hoys* case is distinguishable on this ground. Apart from this distinction, however, we think the decision in *Hoys* is wrong, just as was the prior decision of the same court in *Holmes* (148 F. 2d 740), which was reversed by this Court. For the reasons stated above, we believe the Fifth Circuit, merely mentioning the *Holmes* decision as an authority invoked by the Government, misconceived the definition of "enjoyment" established by that authority, a definition which should have been controlling in *Hoys* as it is here.

II

IN ANY EVENT, THE INTERESTS OF THE BENEFICIARIES WERE NOT INDEFEASIBLY VESTED, SO THE SINGLE GROUND ON WHICH PETITIONERS ATTEMPT TO DISTINGUISH THE HOLMES DECISION DOES NOT EXIST

Our argument preceding this point assumes with petitioners, as did the court below, that the decedent's children had indefeasibly vested interests in the corpus and accumulated income of the trusts. This assumption constitutes the sole basis on which petitioners attempt, unsuccesfully in our view, to distinguish the *Holmes* case. But even this attempt is groundless if, as we argue here, the interests of the beneficiaries were not indefeasibly vested.

1. From the New York cases on which petitioners base their laconic assertion (Br. 11) that the interests of the beneficiaries were "beyond

any doubt * * * unconditionally vested," only one thing is clear beyond doubt—namely, that whether there was such unconditional vesting turns on the intention of the settlor, which is to be gleaned from the terms of the trust instruments and the surrounding circumstances. Realistically stated, the problem here is to determine what the settlor would have said, had he said anything, as to the disposition of the trust assets if the beneficiaries died before they became entitled to receive them.

Briefly summarized, the relevant terms and circumstances of the trusts were these: Each trust was created very shortly after the birth of the child named as beneficiary. The settlor, naming himself as trustee, retained the unlimited powers he had had before the transfers to control, invest, and reinvest the properties for the ultimate benefit of his children if they survived. He was "to collect and receive the income" of the trust, accumulating it in his discretion, "such accumulations of income, if any, *to be paid over to* [the beneficiary] *upon his reaching his majority*, the principal of said Trust Estate or the remaining portion thereof *to be paid over* to the [beneficiary] *when he shall have reached the age of twenty-five years*" (R. 5–6, emphasis added). Until the time which the terms of the trust provided for "payment over," the beneficiary had no right to either principal or income, a fact emphasized by the provision that payments of principal, in the discretion of the trustee, "shall be entirely freed

decedent in this case, to terminate by distributing the trust principal to the current beneficiaries is a power "to alter, amend, or revoke" within the meaning of Section 811 (d) (2). Accordingly, decision here turns on the narrow question whether the decedent's power was one which would have effected "any change" in the "enjoyment" of the trust interests he had transferred. We think that this issue, too, must be resolved against petitioners on the authority of *Holmes*.

In the *Holmes* case, this Court reaffirmed the now settled principle "that 'enjoyment' and 'enjoy,' as used in these and similar statutes, are not terms of art, but connote substantial present economic benefit rather than technical vesting of title or estates." 326 U. S. at 486. Viewed in this light, it scarcely advances the inquiry here to insist, as petitioners do, that because their heirs were "carried within them" during their lifetime, the beneficiaries had full enjoyment of the trust properties which was not subject to "any change" by the decedent. For the fact is that throughout the period of the trust, and certainly at the time of his death, the decedent had plenary power to confer upon the beneficiaries either "substantial present economic benefit" or no present benefit at all.

Retaining unfettered powers as trustee to control, invest, and reinvest the property he had transferred in trust—and thus, in an important economic respect, retaining the powers that out-

right ownership had given him before the transfer—the settlor decedent also reserved the right to accumulate or distribute the trust income during the minority of the beneficiaries. (All three were still minors at his death.) In addition, while the beneficiaries were not to [1]receive the principal under the terms of the trust until they reached the age of 25, the settlor here, like the settlor in *Holmes*, reserved the power to distribute the principal to them at any time before then. In a word, the settlor possessed at the time of his death the same kind of power as that involved in *Holmes*—the power to give to the trust beneficiaries present enjoyment of all the trust assets, enjoyment they might otherwise never have known had they died during the term of the trust.

The assumption that the beneficiaries' interests were "indefeasibly vested" is, we think, substantially meaningless as a practical matter in the circumstances of this case, and cannot justify escape here from the estate tax imposed in *Holmes*. It is to be noted, first of all, that only one of the three beneficiaries in this case had reached the age of 18 when the decedent died (see R. 2, 26), so that only this one of the three had power to make a will.[1] For the first eighteen years of each trust—and as to two of the trusts at the time when the decedent died—the only

[1] N. Y. Decedent Estate Law, § 15 (McKinney's Consol. Laws of N. Y., Bk. 13).

significance of the assumption that the beneficiaries' interests were indefeasibly vested is that the persons who would take on their deaths were named in New York's law of intestate succession rather than in the trust instruments. In other words, at least while the beneficiaries were under 18 years old and unmarried, petitioners' argument would mean that the trust assets would have been taxable in the decedent's estate (under *Holmes*) had the trust provided for gifts over to the decedent and his wife upon a beneficiary's death, but that the tax may not be imposed here though the absence of a specific provision in the trusts made no difference in this respect since the same disposition of the trust assets would have been required under the New York Decedent Estate Law, § 83.

But going beyond the point when each of the beneficiaries would have reached the age of 18, petitioners err in assuming that, in terms of the substantial economic realities with which the estate tax is concerned, the power to pass property at death by will is the same as the present right to possess, use, and dispose of property during one's lifetime. Their view is refuted by *Mellon* v. *Driscoll*, 117 F. 2d 477 (C. A. 3), certiorari denied, 313 U. S. 579, a decision which seems particularly significant here since it was one of the cases forming the basis for certiorari in the *Holmes* case and was cited there with approval by this Court. See 326 U. S. at 483, n. 2, and 489,

n. 11. In the *Mellon* case, the decedent, who died in 1934, had created in 1917 spendthrift trusts for his two children,[1] with a trust company as trustee. The trustee in each instance was directed to pay the income to the child for life, and upon the child's death to distribute the principal and any undistributed income to such persons as the life beneficiary might designate by will. In the absence of such direction, the trustee was to distribute the property to those who would take as the life beneficiary's heirs under the intestacy laws of Pennsylvania. The decedent reserved the right to revoke each trust, whereupon the principal was to be distributed to the named child. In holding that the remainder interests were includible in the grantor's gross estate, the Third Circuit pointed out (p. 479) that the provision taxing interests in the "enjoyment" of which the decedent retained power to make "any change" (there Section 302 of the Revenue Act of 1926, c.

[1] The Court of Appeals in the *Mellon* opinion refers to the children as minors. The record in the case (No. 364, October Term, 1940) shows that one child was thirty and the other thirty-seven at the time the trusts were created. Under the trust instruments, there was no power in the trustee or the decedent to accumulate income, and an estate for the life of each beneficiary was excluded by the Commissioner from the decedent's estate. *Cf. Kahn v. United States*, 257 U. S. 244, 245; *In re Ipsen's Estate*, 295 F. 2d 479 (C. A. 2). Here, where the decedent possessed at the time of his death power to accumulate the income of all three trusts, petitioners make no claim that if the assets were taxable in the decedent's estate, some portion was excludible.

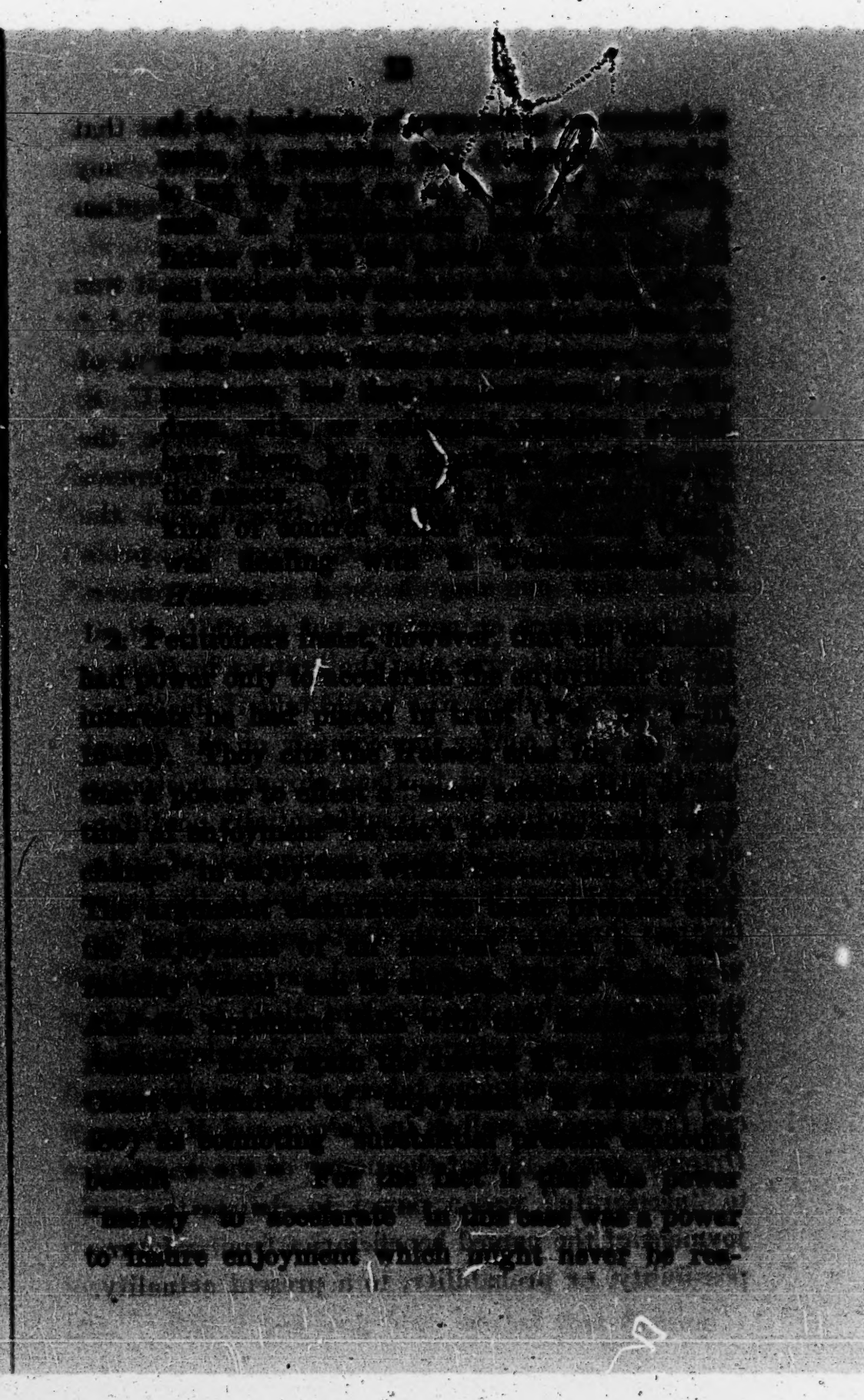
37, 44 Stat. 9, now Section 811 (d) (2) of the Internal Revenue Code) was so comprehensive as to include all powers other than those "affecting trivial and unimportant matters." * * *"[1]

Whatever technical differences there may be between the power to pass "indefeasibly vested" property rights at death and the power to convey such rights by will under an irrevocable general power of appointment, like that given to the beneficiary in the *Mellon* case, there are no dif-

[1] *See also Commissioner* v. *Hogle's Estate*, 170 F. 2d 913 (C. A. 8), petition for certiorari dismissed per stipulation of counsel, 337 U. S. 967. In that case the decedent, as trustee of five trusts created by him, had had the power to determine whether gains from sales of trust assets should be credited to corpus or income, power to pay out accumulated income in the sole discretion and to make determinations as corpus or income, but no power to encroach. The children and grandchildren named as beneficiaries were given the income and the power to appoint the remainder by will, with gifts over in default of appointment. The Court of Appeals held that the entire value of the trust assets was includible in the grantor's gross estate under Section 811 (d) (2) on the ground (p. 916) that the grantor had retained "a substantial power to shift or control the beneficial enjoyment of the income as between the life beneficiaries and the remaindermen, even though he could not shift it to himself or to the estate by exercising the power, completely eliminate the remainder interest." The case was additionally decided on the basis of [illegible] grounds, namely that the value of all transfers made [illegible] the creation of the trusts with respect to which the decedent had retained no power at death was includible in that it [illegible] the value of all accumulated income and realized gains and excluding the value of the original corpus.

between which matter lies? Indeed, clause 2(2) [illegible] of the Income Tax Act [illegible] such interest as being admissible for that purpose. The significant point here is that the [illegible] that property will pass at death [illegible] application of death is a palpably and substantially different thing from the present right to enjoy income or the use of the property. As the court below said (32 31-32):

"... The power of the widow to pay over the principal sum, or only the power to determine whether she should or should not have the property. As the [illegible] was not a mere question of [illegible] payment, of whether he should enjoy the property earlier or later, but whether he should enjoy it at all or not. The [illegible] fication of a living person with [illegible] in the [illegible] case of [illegible] type of [illegible] [illegible] [illegible]



[redacted]

Driscoll, supra, is that the power of the trustee to "accelerate" was a power to change the enjoyment of the named beneficiaries from a future possibility, or probability, to a present actuality.

[redacted]

(Br. 17) that powers which "are not sufficient to render the gift incomplete, * * * are likewise insufficient for estate taxation under Section 811 '(d).." But it has long been settled that Section

[redacted]

[redacted]

[redacted]

[redacted]

to judicial supervision and a duty to account, the decedent would have acted under restrictions designed to preserve the world's ethics, prompting from trustee to, and not to the minor of his property. As trustee, viewing the situation in practical terms, the decedent was free to have over both income and accumulated principal for all the modern cars and trips abroad that late adolescent desire and parental indulgence might dictate. Or, as his trusts carefully provided, the decedent could withhold any of these rights of enjoyment. Cf. *Stifel v. Commissioner*, 127 F. 2d 107 (C. A. 2).

As guardian, moreover, the decedent would have lost altogether his hold over the trust assets when the children reached majority. But as trustee he retained the power to withhold the principal from them until they reached 25. It is scarcely realistic to suggest that a change from a right to the custody of property to unfettered control and use of the property represents no change in enjoyment.

There are, in short, vital differences between guardianship and the broad powers the decedent

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of N. Y., Sec. 14, 1953 Supp.); *Delaplaine v. Barrett*, 270 N. Y. 38, 42, 43.

Of course, the decedent's status as father of the children would not in itself have entitled him to control and invest their property. *Foley v. Mutual Life Ins. Co.*, 148 N. Y. 236; *Matter of Waldberg*, 172 Misc. 104, 15 N. Y. S. 2d 203, 39 C. J. S. 110. Presumably, in the unlikely assertion of petitioners' hypothesis (gift by the father with father as guardian) the guardianship they suppose would result from a court order and subject the father to the usual restrictions on guardians.

retained in this case. The decisive point here is that the decedent at his death retained power to change substantially the enjoyment of the interests he had conveyed—the fact which requires inclusion of those interests in his estate in accordance with the plain terms and purpose of Section 811 (d) (2). Nothing in this conclusion suggests that in the far different situation of a guardian—strictly limited by judicial supervision in both the time and manner of his control—his estate would be taxable on the property of his ward.

5. The primary authority upon which petitioners rely for their view that the court below has erred is the decision of the Court of Appeals for the Fifth Circuit in *Hogg' Estate* v. *Commissioner*, 181 F. 2d 169. In that case the decedent had created a trust for the benefit of her four children, naming herself as trustee. The instrument provided that she should pay to the beneficiaries so much of the income as she deemed for their best interests and accumulate the remainder. She also reserved the power to terminate the trust in her discretion. Upon termination of the trust, either by death of the settlor or by her prior decision to terminate, the property was to go to the beneficiaries in equal shares or, in the event any of them were dead, to his heirs under the laws of descent or distribution of the State of Mississippi. The Tax Court (12 T. C. 210) held the property includible in the decedent's gross estate under the *Holmes* decision, pointing out (p. 215) that she had held during her life the

power through termination to make certain that the existing beneficiaries would come into the enjoyment of their shares of the trust estate, "an eventuality which might have been prevented by their failure to survive the grantor."

Reversing, the Court of Appeals observed (p. 172) that the decedent had stripped herself as an individual "of every vestige of beneficial interest in the land and of every power over it. The two unexercised powers here involved were granted to her as trustee, and were subject to the control of a court of equity."[*] The court concluded that the value of the land could not be included in the decedent's estate because, construing the terms of the trust instrument under Mississippi law, it was clear that she had conveyed to the beneficiaries an inheritable estate in fee."

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[*] The suggested distinction between a power exercisable by the settlor as such and by him as trustee is, we believe, clearly immaterial, and is not pressed by petitioners as a basis for their position. Section 811 (d) (1), applying to transfers after June 22, 1936, refers to powers "in whatever capacity exercisable", but the quoted language has been held merely declarative of prior existing law applicable under Section 811 (d) (2) to transfers made on or before June 22, 1936. *Welch* v. *Terhune*, 126 F. 2d 626 (C. A. 1); *Union Trust Co. of Pittsburgh* v. *Driscoll*, 138 F. 2d 152 (C. A. 3); cf. *Commissioner* v. *Estate of Holmes*, *supra*, at 489-490, especially footnote 13, p. 490.

[*] In a decision involving a Minnesota trust, the District Court for the District of Minnesota has followed the Fifth Circuit's decision in *Hays' Estate*, postponing the entry of judgment until the decision of this Court in the instant case. *Barney* v. *Kelm*, 53 CCH, Federal Estate and Gift Tax Reporter, ¶ 10,915 (July 31, 1953).

from the trust created hereby and shall be the absolute property of the payee" (R. 6). There was no express provision of any kind for disposition of the property in the event of a beneficiary's death during the term of the trust.

In petitioners' view, the settlor must be deemed to have intended that, if a beneficiary had died at the age of two or five or ten the property would go to the beneficiary's estate. Or that a beneficiary dying at eighteen could have willed the property to a friend or any chance object of his bounty. But the very first case petitioners cite for this conclusion goes far to refute it.

Manufacturers Trust Co. v. *Chase National Bank*, 282 N. Y. 790, affirming 258 App. Div. 767, affirming 171 Misc. 49, involved an *inter vivos* trust, providing in part as follows (171 Misc. at 49–50):

> Upon the death of [the first life beneficiary, settlor's sister], the said "Trustee" shall divide the trust fund into two (2) equal parts, and shall hold one of such parts in trust for the benefit of my niece, Constance Lichter and apply the income and profits therefrom to her use until she shall attain the age of twenty-five (25) years and in the event that she attains the said age of twenty-five (25) years, she shall thereupon become entitled absolutely to the said equal part * * *.

The close resemblance of the quoted provision for Constance Lichter to the provisions in the instant case is readily apparent.

Constance Lichter died before reaching twenty-five, having received her share of the income until then, and the problem before the New York courts was whether the capital which would have gone to her had she lived to the age of twenty-five should go to her estate or to the estate of the settlor. The Supreme Court, which wrote the only opinion in the case and was affirmed without opinion by the Appellate Division and the Court of Appeals, observed, referring to the trust language we have quoted (171 Misc. at 30):

> If there were nothing more in the trust deed than the clause above quoted it would probably be necessary to hold that the acquisition by Constance Lichter of any right to receive her share of the capital of the trust was contingent upon her attaining the age of twenty-five years, and that in the event of her death before reaching that age the fund would revert to the settlor or his estate.

The court went on, however, to point out that the settlor had contemplated the possibility of Constance's death before reaching twenty-five, had provided for various alternative dispositions (omitting only the eventuality, which materialized, of Constance's death after the prior life beneficiary but before age twenty-five), and had effectively shown by these arrangements an intention which was more nearly fulfilled by giving the fund to Constance's estate than by a reverter to the settlor's estate.

The point here, of course, is that there are no such additional factors, and the statement quoted from the court's opinion squarely applies. Indeed, with *inter vivos* trusts generally, as contrasted with wills, there is sound reason for refusing to "imply an intention of effecting a full and complete disposition of the trust property unless an intention so to do is clearly indicated." *In re Fields' Trust*, 276 App. Div. 835, 836, 93 N. Y. S. 2d 267, 269, modified, 302 N. Y. 202.[11] As Mr. Justice Reed observed, concurring in *Spiegel* v. *Commissioner*, 335 U. S. 701, and dissenting in *Commissioner* v. *Church*, 335 U. S. 632, it is a—

> firmly settled principle that where an express trust fails for lack of a beneficiary, a resulting trust in favor of the settlor arises by operation of law. To vest property under a will or deed is desirable. To vest property under a trust may not be. It is more reasonable to return trust property to the settlor on failure of the trust than to have it go to the heirs of the beneficiary. [335 U. S. at 665.]

This conclusion seems particularly compelling when we consider the tender age of the beneficiaries when the trusts in this case were created

[11] The Court of Appeals, modifying the decision of the Appellate Division from which we have quoted, found a clear indication that the settlor in that case had intended to preclude any possibility of reverter. But it cast no doubt on the relevance in a proper case of the guide to construction referred to in the lower court's opinion.

and the broad powers of control reserved by the settlor. The intention petitioner imputes to the settlor would have channeled the assets potentially through the estate of a deceased infant beneficiary or have left them to pass under the will of a child whose maturity the settlor deemed insufficient to relinquish his control to them. It seems far more likely that the settlor would have preferred that these properties be continued in existence and grant for his children should remain subject to disposition by him should one of the children fail to live to enjoy his share. Paraphrasing this Court's appraisal of the similar problem in *Chater v. Chater*, 293 U. S. 572, 580:

> [The children were] the chief object[s] of the bounty. What [they were] to receive, and when [they were] to receive it, were stated in plain terms. Beyond this, we think there are none of the implications that are deemed to arise in cases of wills.

The conclusion in the *Chater* case is plainly appropriate here; had a beneficiary died before receiving the trust assets, the trust would have failed and there would have been "a resulting trust for [the donor]." *Ibid.*; see also, *Guaranty Trust Co. v. New York Trust Co.*, 297 N. Y. 45, 51; *Furman v. Cruikshank*, 230 N. Y. 425; Bogert, *Trusts and Trustees*, Vol. 2A, Sec. 469.

This view is supported not only by the logical and practical considerations already mentioned but by the rule of construction commonly applied in New York [illegible] of gift are [illegible] may at a [illegible] mediate contingent [illegible] *Crosse*, 164 N. [illegible] to the same effect [illegible] *Will*, 37 N. [illegible] *Estate*, 164 N. [illegible] App. Div. 961.[2] Whatever the [illegible] canon standing alone (see note 15, *supra*), its application in the present case is readily appropriate. The settlor used words of survivorship and the purpose of his transfers was such that, unless he himself saw fit at some time to advance the time for receipt of the property by his children, they were not to have it before the time appointed in the trust instruments. It scarcely comports with this retention of parental control to suppose that the settlor intended, upon the death of one of the children, to let the property pass to the child's estate. The law of New York, far from

[2] In 2 Powell on *Real Property* (1950), par. 382, p. 142, the rule is severely criticized and it is shown to be encountering judicial disapproval in many quarters. However, as indicated by the two cases last cited, decided in 1950 and 1951, the rule survives in New York.

for accumulation in New York must give the beneficiary a vested interest in the sense that, upon surviving his minority, the beneficiary is absolutely entitled to the accumulated income. But it is equally clear that the vested interest may be subject to defeasance. Section 16-a of the New York Personal Property Law provides that a direction for the accumulation of income may be "accompanied by the creation in [a person or persons other than the minor beneficiary] of an interest with respect to, or by the reservation of a reversionary interest in favor of the settlor, or of his successors in, the income accumulated during the minority prior to the time of the death of the minor, provided that the interest so reserved or created is to become effective only in the event of the death of the minor during minority." This provision, enacted in 1948, merely confirmed a rule that had existed long before (see the Historical Note to Section 16-a in McKinney's Consol. Laws of N. Y., Bk. 40, p. 102; and see pp. 42, 43-44, *infra*), and petitioners do not suggest that their decedent lacked the power, if he so intended, to create in himself a possibility of reverter as to the accumulated income. They appear to contend, however, that the decedent should not be deemed to have intended any such possibility.

Of the two cases petitioners cite for their view (Br. 11), one, *Morris* v. *Morris*, 272 N. Y. 110, held merely that an accumulation for anyone other

than a minor was invalid. There is dictum in the case which could be said to suggest that we are but the minor may even benefit from an accumulation, but this is inconsistent and, only with the subsequently enacted Section 16-a of the Personal Property Law (passed in 1949), but also with other pronouncements of the New York Court of Appeals (see pp. 42-43, infra).

The other leading pre-Surrogate Collins, Smith v. Arnold, 140 N. Y. 116, decided in 1893, did involve a minor but his own personal benefit. There, a testator created a trust for his two daughters, directing the trustee to accumulate the income in his discretion until each girl became 21 and to pay each the accumulations and income for life thereafter. Upon the death of either her share was to go to her issue, and, if she left no issue, to the testator's surviving issue. One of the daughters died during minority leaving an issue, and the court held that the income accumulated for her should go to her administratrix and not as a gift over together with her share of the principal. After reaching this conclusion, the court said (140 N. Y. at 121):

> While we rest our decision in this case on the provisions of the will, we are also of opinion that it is the policy of the statute permitting the accumulations of personal property for the benefit of a minor * * * that they should vest in the infant beneficially when received, and it

is only payment over that is postponed until the expiration of the minority.

The Court also pointed out, however (id. at 153), that there was no doubt

> as to the testator's power to make such disposition of the accumulated income of an infant during minority as he might see fit; there is no legal objection to suspending the gift to any person whether a stranger or a kin, any and such a provision in a will would not violate the statute which provides that accumulations must be for the benefit of infants."

Read in its context, in the light of subsequent developments in the law of New York, and of the fact that it involved a will rather than an inter vivos trust, the decision in *Smith* v. *Parsons* does not support petitioners' view that the trust instrument in this case must be construed to have left no possibility of reverter as to the accumulated income in the settlor. At the time of that decision, almost sixty years ago, New York had no statute expressly permitting gifts over and reversions upon death during minority of a beneficiary for whom an accumulation had been directed. On the contrary, there had been some forty years earlier a square decision holding such gifts over invalid. *Harris* v. *Clark*, 7 N. Y. 242

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[1] To the same effect, see *Rea* v. *Vingut*, 117 N. Y. 204, 217; *Hedgman* v. *Cobb*, 202 App. Div. 259, 265; *People ex rel. Frelinghuysen* v. *Graves*, 248 App. Div. 105, affirmed, 272 N. Y. 517; *Willetts* v. *Titus*, 14 Hun. 554; *Matter of Levy*, 238 App. Div. 480.

(1952). So *Smith v. Parsons* was part of the shifting pattern culminating in 1951 in the enactment of Personal Property Law Section 16-a, which cut away the traditional opposition of the policy against accumulations requiring an accumulation to pass as part of a minor's estate. See the def. *Accumulations and Study relating to Effect (Note on Death of Child of Accumulation During Minority of Child)* in the New York Law Revision Commission's Report for 1951, p. 201 et seq. at pp. 215-216.

Since *Smith v. Parsons*, all vestiges of the need to obtain the consent, during accumulations, of persons presumptively born disappeared. Reflecting the development in judicial decisions leading to the result achieved definitely in New York by Section 16-a of the Personal Property Law, the Restatement of Property defines, in Section 406:

> When an accumulations statute provides in effect, that an accumulation is valid only if it is "for the benefit" of the minor whose minority constitutes the outer limits of its duration, that
>
> . . . . .
>
> (b) in the event that the minor dies during his minority, the income so accumulated can either be reserved to the conveyor or limited in favor of some person other than the minor.

Comment as to this section states:

> In the situation described in Clause (b), "... lapse of the minor intervenes to prevent further personal benefit to the minor. The accumulated income must go either as assets of the minor to the intestate (or, in an unusual situation, to the testate) distributees of the minor, who may be persons not of the blood of the original settlor, or to persons selected by the settlor in the provisions of his conveyance. The statute's requirement that the accumulation be "for the benefit" of the minor is not inconsistent with a disposition of the funds accumulated to persons other than the minor, but effective only if the minor shall have died before attaining majority. Personal benefit of the minor having become impossible, the substituted disposition worked by the settlor to be effective if the minor dies, does not violate the policy of these statutes. [Emphasis added.]

It is to be noted, finally, that in *Smith* v. *Parvus*, where a will rather than a deed was involved, the Court, following a general rule of construction, observed (146 N. Y. at 159): "It will be assumed that the testator did not intend to die intestate as to any portion of his estate." That rule, militating there in favor of finding the accumulation indefeasibly vested, has no application here. Indeed, the implications of the

rule support an opposite conclusion in this case. See pp. 26-27, *supra*. For on petitioner's view, the likely result of a beneficiary's death before majority would have been passage of the property to the beneficiary's intestate distributees. Our position, on the other hand, would mean that the settlor, whose concern was focused exclusively on his children and who reserved plenary power to control and enlarge the trust assets, retained the power to dispose of any of the property as to which the objective of his trusts failed.

3. We submit, in sum, that New York law does not provide the basis on which petitioners seek to distinguish the *Holmes* case. Considering the language and circumstances of the trusts involved here, it would seem that they would be held by the New York courts to have created in the beneficiaries interests vested subject to defeasance by failure of survival. It is clear, at the very least, that petitioners have fallen far short of demonstrating that the law of New York provides the ground they invoke for reversing the Commissioner's determination. Cf. *Helvering* v. *Pitch*, 309 U. S. 149, 156; *Helvering* v. *Leonard*, 310 U. S. 80, 84. Accordingly, even if the asserted rules of state law could, if they existed, require a different result, this case is unmistakably controlled by the *Holmes* decision.

CONCLUSION

The decision of the Court of Claims should be affirmed.

Respectfully submitted.

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APPENDIX

Internal Revenue Code:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

* * * * *

(d) *Revocable Transfers.*—

(1) *Transfers after June 22, 1936.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death;

(2) *Transfers on or prior to June 22, 1936.*—To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or

otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includible under this paragraph;

* * * * *

(26 U. S. C. 1946 ed., Sec. 811.)

Treasury Regulations 105, promulgated under the Internal Revenue Code:

SEC. 81.20 *Transfers with power to change the enjoyment.*—

(a) *Transfers included.*—Subsection (d) of section 811 embraces a transfer by trust or otherwise (if not amounting to a bona fide sale for an adequate and full consideration in money or money's worth) when at the time of decedent's death the enjoyment of the transferred property, or some part thereof or interest therein, was subject to any change through a power exercisable either by the decedent alone, or by him in conjunction with some other person or persons, to alter, or amend, or revoke, or terminate. (See section 81.15.)

The addition to subdivision (d) (1) of the Revenue Act of 1926, by section 805 of the Revenue Act of 1936, of the phrase

to the effect that it is not material in what capacity the power was subject to exercise by the decedent or by the other person or persons in conjunction with the decedent (which phrase is also embodied in subsection (d) (1) of section 811 of the Internal Revenue Code), is considered merely declaratory of the meaning of the subdivision prior to the addition of the phrase.

The second phrase added to this subdivision of the Revenue Act of 1926 by amendment in 1936 (also embodied in section 811 (d) (1) of the Internal Revenue Code), namely, "without regard to when or from what source the decedent acquired such power," is not considered declaratory of the meaning of the subdivision prior to the amendment in a case in which no one of the powers enumerated in the subdivision was reserved at the time of the making of the transfer, but one or more thereof were conferred subsequent thereto (whatever the source from which conferred) without any understanding, expressed or implied, had in connection with the making of the transfer that such power or powers should be later conferred.

The third change made in the subdivision by the Revenue Act of 1936 (which is also embodied in subsection (d) (1) of section 811 of the Internal Revenue Code) consists of the addition of the words "or terminate" following the words "to alter, amend, revoke." Such addition is considered but declaratory of the meaning of the subdivision prior to the amendment. A power to terminate capable of being so exercised as to revest in the decedent the ownership of the transferred property or

an interest therein, or as otherwise to inure to the benefit of the person of his estate; he is then deemed the equivalent of a power to "revoke," and when otherwise so exercisable as to affect a change in the enjoyment, is the equivalent of a power to "alter."

(b) *Taxability.* The property or any interest therein transferred as described in subsection (a) shall be included in the gross estate if it comes within any one of the following paragraphs:

(2) If the transfer was made after the enactment of the Revenue Act of 1924 (6 P. M. eastern standard time, June 2, 1924) and before the amendment of the subdivision by the Revenue Act of 1926 became effective (June 26, 1926), and the power was reserved at the time of the transfer and was exercisable by the decedent alone or in conjunction with a person or persons either having or not having a substantial adverse interest or interests in the transferred property, or in connection with persons one or more of whom had and one or more of whom had not such an adverse interest.